



PENSION SECURITY NEWS

A CalPERS Special Edition Publication | Summer 2005



California's Debate Over Public Pension Plans

A Look Back

The future of public pension funds in California hung in the balance in early 2005. Cost to fund pensions were rising, and some lawmakers were eager to do something about it.

The debate over public pensions began in December when Assemblyman Keith Richman introduced two pieces of legislation—a general session bill and special session bill. The bills, if passed, did virtually the same thing—put an initiative on the ballot that would require every State employee hired after July 1, 2007 to be in a defined contribution plan, and prohibit them from joining a defined benefit plan like CalPERS.

The quest for pension change gained steam when Governor Schwarzenegger announced his support of the pension proposals, and a statewide ballot initiative to create a defined contribution program for new employees and bar defined benefit plans was filed by the Howard Jarvis Tax Payers Association on January 5, 2005.

In his State of the State address, Schwarzenegger called California's pension systems "another financial train on another track to disaster," saying that reforms were needed to ease the financial burden on the State, local employers and taxpayers.

CalPERS Response

In February, CalPERS Board of Administration took an official position opposing Richman's legislation following testimony from the Director of the Department of Finance, and comments from numerous representatives of employee and retiree groups.

The majority of CalPERS Board believed the legislative proposals to move to a defined contribution plan could impact the retirement security of future members and impair our ability to invest assets appropriately. The proposals also didn't clearly provide for death and disability benefits for police officers, firefighters or any other members.

In a turn of events, the Governor in April announced plans to delay pension reform

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Pension Improvement Initiatives in the Legislature

CalPERS is sponsoring a number of legislative bills that, if passed, would provide its staff greater authority to stop abuse and fraud in the System's disability retirement program. CalPERS-sponsored bills currently being considered by lawmakers aim to do the following:

- Improve the definition of fraud in the current law and establish civil and criminal penalties for committing such fraud, including restitution (Torrico, A.B. 456, A.B. X. 15)
- Provide CalPERS the authority to require a disabled member who has achieved the minimum age of retirement to undergo a medical exam to determine his or her current level of disability (Speier, S.B. 105, S.B.X. 13)
- Allow CalPERS investigators increased access to information maintained by the Employment Development Department (EDD) or by workers' compensation insurers with respect to an investigation of benefit eligibility or unlawful application for, or receipt of, benefits (Soto, S.B. 697, S.B.X. 14)

Lawmakers Take Action

Senate and Assembly lawmakers have also advanced their own pension-related legislation to address issues of rising employer contributions, pension spiking and disability retirement fraud.

- AB 804 would require CalPERS to change an industrial disability retirement to a service retirement, if the member is receiving the maximum service retirement amount and is subsequently employed as a peace officer outside of state service. The bill

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initiatives with hopes that a legislative solution can be found instead.

Flanked by government and local workers, Schwarzenegger said he wanted to work with the Legislature, policymakers, and local government in the coming year to help solve the pension issue, but said that he was still prepared to lead a ballot proposal, "...should we not be able to reach an agreement in this building, then they (legislators) should understand that our pension reform proposal will go to the ballot in June 2006."

DB versus DC

Defined Benefit (DB) Plan —

In a DB plan, a retiree will receive a benefit, guaranteed by law, that is determined using a member's years of service, age at retirement and highest one-year or three-year compensation while employed.

Defined Contribution (DC) Plan —

In a DC plan, benefits are determined by the amount of contributions to an account, plus earnings. Members and employers make contributions to the account, and members make investment choices, similar to a 401(k) plan.

CalPERS Takes Action

CalPERS officials recognized the plight of employers in meeting their financial obligations to fund pensions and set on a path to provide some relief.

Last year, CalPERS staff and Board launched a number of initiatives to address rising employer pension costs, including workshops with employers and a survey that sought input on how to address employer rate fluctuation.

CalPERS had three goals. First, minimize the volatility in the contributions paid

by employers. Second, reduce the average future employer contribution. Third, ensure that the solutions would not impact our ability to pay benefits.

An additional goal was to find a solution that complied with the generally accepted accounting standards set forth by the Governmental Accounting Standards Board.

CalPERS staff presented a plan to "smooth" contribution rates made by employers from year to year—whether investment returns go up or down.

The idea is to eliminate the volatility in employers contributions that are created by fluctuations of CalPERS investment earnings.

For example, when investment returns rise in a booming market, employer contributions fall—sometimes to zero, as they did for school employees for four straight years. When CalPERS investments dip during market downturns, employer contributions must go up to keep the pension system solvent.

The plan was adopted by the CalPERS Board of Administration, and complies with accepted accounting standards without undermining CalPERS ability to pay pension benefits as promised.

The plan is also consistent with one of the goals of the Governor and his Administration—to allow the State to eliminate the volatility in what the State and other public employers pay from year to year.

At a State hearing on this issue the Governor's Finance Director, Tom Campbell, said he welcomes any restructuring of pension contributions that won't burden taxpayers who pay the bills.

"If there is a chance of structuring something that would be responsive to those concerns while preserving that one fundamental—that the taxpayers not have to be on the hook in case of a market decline—I'm really very, very eager to do so," said Campbell.





pension security

How CalPERS is Funded

There are three primary funding sources to make sure that CalPERS has money to pay retirement benefits:

1. Your contribution—most members of CalPERS pay for a portion of their retirement by making a contribution from their paycheck.
2. Your employer—this contribution can change each year. Your employer makes a contribution toward your retirement and the amount depends on how well CalPERS investments perform.
3. Investment earnings—this is the last funding source and the most important. The better CalPERS investments perform, the less employers and taxpayers have to pay. More than 75% of income to fund pensions came from good investment earnings during the last decade.

With CalPERS new plan, the State will pay \$186 million less in pension costs for State employees and \$77 million less for school in the fiscal year that begins July 1, compared with the previous year. Public agencies will see the effects starting in July 2006.

CalPERS Investments Gain 12.7%

News for CalPERS members and employers got even better recently. CalPERS earned a 12.7 percent return on its investments for the one-year period ended June 30, 2005, raising our portfolio's market value to a record \$189.8 billion. Our strong performance, combined with our new employer rate smoothing policy, will result in more

stable and lower employer contribution rates in the future for the State of California and public agency employers.

The Latest on Pension Security

CalPERS Board is also considering establishing rainy day accounts for employers. Employers would pay a minimum contribution each year despite fluctuations in the market. The reserve account could be used when rates rise.

The legislative bills introduced by Assemblyman Richman failed in the legislature, but the Governor continues to say that he will place an initiative on the ballot next June if the pension issues are not resolved in the legislature. •

Pension Improvement Initiatives in the Legislature

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would also exempt the CHP from making certain types of disability indemnity payments if the injured employee is a peace officer and receiving the maximum allowance as specified, and requires a workers' compensation insurer to disclose to the CHP information for the purpose of investigating workers' compensation insurance fraud (La Suer)

- A.B. 1568, A.B. X. 14 would establish a Taxpayer Risk Reduction Account for each CalPERS employer. The accounts would be held as an employer asset and funded by all or a portion of employer contributions when the actuarial value of assets exceeds the present value of benefits. The account may be drawn upon to pay a portion of the employer contribution when the employer contribution rate is greater than the normal cost of benefits. (Torrico)
- S.B.X. 12 would also establish Taxpayer Risk Reduction Accounts for employers to use when contribution rates are greater than normal costs (Dunn)

For updates on legislation, please select "Bill Information" on the Official California Legislative Information Web site at <http://www.leginfo.ca.gov/>.

Keeping You Informed

No doubt, you have been asked a lot of questions about the pension debate.

Who pays for CalPERS retirements?

How much do members make in retirement?

Is a 401(k) better?

We have received the same questions from many of our members, retirees, employers and stakeholders. In an effort to answer those questions and keep you informed, CalPERS has developed the "Pension Reform Debate Information Center" on our web site at www.calpers.ca.gov. The center is full of fact sheets, studies and articles about pensions. It also outlines the pros and cons of defined benefit and defined contribution plans.

Take some time today to learn more about your pension, and be prepared to answer those questions about the true value of CalPERS and your pension.





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INSIDE: Important Information About Your Pension!

Dear CalPERS Members

I am writing to you for a very important reason—to update you on the security of your retirement pension.

As you may be well aware, the news over the last year has been filled with information and misinformation about the future of defined benefit pension plans like CalPERS. It started when California's Governor and several lawmakers proposed eliminating public pension funds and creating a 401(k)-style defined contribution plan for new employees.

The purpose of this newsletter is to provide you, and all our valued members, an update on the debate over pensions in California.

Inside you will find information about current legislative proposals making their way through the Legislature. You can also read about what CalPERS has been doing to help buffer the rising costs of pensions.

CalPERS and other public pension funds have been a proven investment for the taxpayers of California. More than 75 percent of income to fund pensions came from good investment earnings during the last 10 years, and

we are plowing billions of dollars into California to revitalize urban communities, build homes, and create jobs.

Defined benefit pensions encourage public employees to devote their career to public service.

The system has worked well for 73 years. We are working to improve the system and we are on track to provide retirement security for another 70 years and beyond.

Sincerely,

Fred Buenrostro
Chief Executive Officer

